

H.3652 “Put Parents in Charge Act” State Revenue Loss and Expenditure Savings

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This analysis was prepared to meet the requirement of Section 2-7-71 for a state revenue impact, and Section 2-7-76 for a local government revenue impact from the implementation of H. 3652 the “South Carolina Put Parents in Charge Act.” This proposed legislation would create tuition tax credits to cover tuition paid by families to independent schools and to cover expenses of families who home school their children. The proposal would also create scholarship tax credits for contributions to scholarship granting organizations beginning in FY 2006-07.

Estimated State Revenue Impact (Section 2-7-71)

To help determine the extent to which the income tax credits will be taken, we estimated the distribution of students in the state according to levels of taxable income. For a family with two children filing jointly, taxable income will average \$20,000 less than adjusted gross income because of the deductions and personal exemptions. Because of the phase-in provisions of the bill, we estimated the distributions according to grade size for public, private and home schooled students. These distributions are provided in the attached tables.

To illustrate, referring to the Table “Distribution of Public School Children by SC Taxable Income for H. 3652, FY 2006-07” there will be 64,677 public school students whose families will have taxable incomes between \$50,001 and \$75,000. Of these, 24,507 will be in grades K through 4, the eligible students in the first year of the phase-in. For these students, the average tuition tax credit will be \$1,462 per student. For families with taxable incomes between \$35,001 and \$50,000, the average credit will be \$1,193. Except for the first year of the bill’s implementation when the tuition tax credit may not exceed one-half of the subsequent year’s amounts, the average tax credit for families with incomes below \$50,000 will be limited by the amount of their tax liabilities, which is provided in column 3. Under a general provision of the state income tax code, these credits will not be refundable, which means that they will be limited to the amount of a taxpayer’s income tax liability.

Public School Students with Family Taxable Incomes Less than \$35,000. The number of families that will transfer their children from public school as a result of the tuition tax credit was

difficult to estimate. We did not feel that the state's revenue collections will be exposed to financial risk for families whose taxable incomes will be below \$35,000. Families with taxable incomes of less than \$35,000 have state income tax liabilities that are well below the proposed per student tuition tax credit. We expect that the tuition tax credit for these families will average \$806 or less in the first year when the credit for all practical purposes will be limited to one-half of a family's tax obligation. This amount will rise to at most 1,674 in the second year of implementation when the first year's one-half restriction is ended, and reach \$1,875 in the fifth year. We do not expect that this level of tax credit will be sufficient to cause hardly any families to transfer their children.

Public School Students with Family Taxable Incomes Between \$35,001 and \$50,000. For families whose incomes will be in the range of \$35,001 to \$50,000, we do believe that there is a modest financial risk to the state's revenues as a result of the credit. The amount of the credit for these families will range from \$1,193 to \$2,776 during the five year phase-in. Their credits, except for the first year of implementation, are identical to their estimated state income tax liability as the proposed tax credits exceed their tax liabilities. This amount will help pay approximately one-fourth, or less, of the costs of independent school, which range from \$6,000 to \$11,000 per year, as seen in the table below. Because the additional amount of their own income that these families would be required to pay for independent school tuition will be substantial relative to their incomes, we do not expect many families in this bracket to transfer their students to independent schools. Consequently, the financial exposure to the state will be small from this income bracket. We expect that the state will need to cover tuition tax credits for 5% of these families, or credits for 1,339 students in the first year for a total cost of \$1,598,288.

Independent School Tuition Survey for Columbia Area	
School 1	\$ 7,656
School 2	\$ 8,748
School 3	\$ 9,600
School 4	\$10,895

Public School Students with Family Taxable Incomes Between \$50,001 and \$75,000. We estimate the financial risks to the state will be greater for families in the \$50,001 to \$75,000 taxable income range. For these families the credit will average \$1,462 in the first year and increase to \$3,292 once fully implemented. This higher level of credit will provide more incentive to transfer students from public to independent schools. The credit will still amount to only a small portion of independent school tuition. We estimate that the state will need to cover tuition tax credits for 10% of these students, amounting to \$3,872,746 in tax credits in the first year.

Home School Tax Credits. The proposed tuition tax credit will be available for families that home school their children up to the actual expenses incurred. We expect the home school credit to average \$384 for K-1 students in the first year. We expect the 2,021 students will be eligible for the credit, amounting to \$777,219 in the first year. When fully implemented in FY 2010-11, we expect 16,198 home school students will be eligible, and their tuition tax credits will total \$9,336,975.

Independent School Tax Credits. We expect that the largest financial exposure from the tuition tax credit will be the credits taken by the families of independent school students. In the first year, we estimate that tuition tax credits for 6,713 students will be claimed. The average tuition tax credit is be \$930 as the tax credit is non-refundable and limited to the families' state income tax liabilities. The total amount of exposure for the first year is expected to be \$6,240,118. When the phase-in is complete in FY 2010-11, we expect that tuition tax credits for an estimated 50,824 independent school students will amount to \$104,395,220.

Scholarship Tax Credit. We expect that the financial exposure to the state will be substantial from the proposed scholarship tax credit. Individuals and corporations would be eligible to donate to the scholarship granting organizations and claim the 100% scholarship tax credit. No other state allows both individuals and corporations to earn tax credits. Scholarship granting organizations may grant scholarships based on the same criterion that guides the tuition tax credit, ranging from \$2,924 to \$3,292

annually as used in our analysis. Students can receive the tuition and scholarship tax credits in the same year.

The major factor in limiting the financial exposure of the state from the scholarship tax credit is the financial capacity of the donors to utilize more tax credits. To estimate the financial exposure to South Carolina, we relied on the experiences from two states to assess the exposure from individuals and corporations. Based on a review of actual experience in Arizona and Florida, we expect donations to scholarship granting organizations to total \$16,598,157 in the first year, generating tax credits of the same amount for these taxpayers. Scholarship tax credits are expected to total \$86.2 million by FY 2010-11.

Summary of Estimated State Financial Exposure from Both Credits. In the first year we anticipate a total of 12,661 students will generate tuition tax credits of \$12,437,875. We further anticipate that donations to scholarship granting organizations for scholarship tax credits will total \$16,598,157. The total revenue reduction is expected to be \$29,036,032 in FY 2006-07. By FY 2010-11, we anticipate 77,253 students, 10,071 from public schools, 16,198 from home schools, 50,824 from private schools, and 160 in-migrants to claim \$145,392,616 in tuition tax credits. Contributions from individuals and corporations to scholarship granting organizations are expected to create scholarship tax credits that total \$86,197,454, for a total revenue reduction of \$231,590,070 in that fiscal year. The table below summarizes the state revenue impact.

	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Public School Students Claiming Tuition Tax Credit	3,790	5,431	7,082	8,882	10,071
Total Students Taking Credit	12,661	19,521	35,304	58,174	77,253
Tuition Tax Credit Total	12,437,875	37,502,811	66,534,233	107,405,776	145,392,616
Scholarship Tax Credit Total	16,598,157	24,620,257	40,264,616	64,117,314	86,197,454
Total Tax Credits	29,036,032	62,123,068	106,798,849	171,523,089	231,590,070

Estimated State Appropriation Reduction

The maximum cost savings the state could expect in FY 2006-07 would be the full amount of state appropriations of \$4,810 in average state per pupil expenditures for K-12 school operations. The definition of average state per pupil expenditure in the proposed bill includes all direct and indirect expenditures by the state for public education and also includes debt service on state bonds issued to fund school district capital improvements and other expenditures not directly tied to per pupil spending. If the state were to reduce appropriations by this per pupil amount for each student that transfers, the reduction would total \$18,299,900. Not all state appropriations, however, are directly tied to the number of students. For example, in addition to the state debt payments for local school district capital improvements, \$391.3 million in school district property tax reimbursements from the Property Tax Relief Trust Fund are included in the \$4,810 estimate. These appropriations are allocated to school districts, but are mandated by law for property tax relief. These reimbursements would not be affected by a reduction in the number of public school students.

Based on data from the state Appropriation Act and the Local Government Finance Report, we estimate that expenditures directly related to the number of students, such as EFA funding and school district employer contributions account for 58% of all state expenditure for K-12 school operating expenditures. We estimate the expenditures that are mainly a function of the number of pupils to amount to \$2,790 per pupil. Multiplying this estimated \$2,790 per student times the number of students moving to independent schools provides estimates of the reduction in state appropriations if the state chose to implement these per pupil reductions. For the first fiscal year, the state could reduce appropriations to public education by \$10,573,342 to help offset the financial exposure to the loss of General Fund revenue from the tax credits.

Potential State Revenue Reduction

Fiscal Year	Students Moving to Independent Schools from Public Schools	58% of Avg. State Expenditures for K-12 Operations	Potential State Appropriation Reduction
FY 2006-07	3,790	2,790	\$10,573,342
FY 2007-08	5,431	2,873	\$15,605,946
FY 2008-09	7,082	2,960	\$20,960,587
FY 2009-10	8,882	3,048	\$27,076,686
FY 2010-11	10,071	3,140	\$31,622,381

Estimated Local School District Expenditure Reduction

We expect the potential local school district expenditure savings to be based on the anticipated reduction in the number of teachers and a small amount of the remaining fixed costs. Other expenditures for counseling, libraries, building upkeep, and leadership positions would generally not be reduced for the anticipated marginal reduction in the number of students. Once the Act is fully implemented in FY 2010-11, we estimate that a total of 10,071 students would move from public schools to independent. This expected reduction amounts to less than 1.5% of the expected 675,000 public school students in FY 2010-11.

Using this estimate of the reduction in students, we estimated the reduction in spending that would occur provided that the students per teacher ratio would be maintained. The estimate anticipates that the school districts will not reduce the number of students per teacher below the current estimated ratio of 20 to 1. We expect that maintaining the same teacher – pupil ratio will necessitate restructurings of classes and courses. In addition to the teacher reductions, we expect that the school districts would be able to reduce expenditures on the remaining costs by 5%.

Local expenditures will also be impacted by the actions taken at the state level in their funding of K-12 operations. Appropriation reductions, if implemented at the state level, will reduce the total revenues used to fund K-12 operations at the school district level. The estimated potential state appropriation reductions, based on expenditures directly related to students, are included in the table below. We estimate that local school districts would have a net shortfall of \$1,538,290 in FY 2010-11 due to reduced state appropriations.

Fiscal Year	Students Moving to Independent Schools from Public Schools	Estimated Reduction in the Number of Teachers - 20 to 1 Student to Teacher Ratio	Estimated SC Average Teacher Salary	Estimated Per Pupil Local Expenditure Reduction (Teacher Salaries plus 5% of total local expenditures)	Estimated Total Local Expenditure Reduction (Teacher Salaries plus 5% of total local expenditures)	Estimated Potential State Appropriation Reductions	Estimated Potential Local Revenue Increase Net of State
FY 06-07	3,790	190	\$43,805	\$2,696	\$10,218,935	\$10,573,342	\$354,407
FY 07-08	5,431	272	\$44,901	\$2,757	\$14,974,082	\$15,605,946	\$631,864
FY 08-09	7,082	354	\$46,023	\$2,838	\$20,098,716	\$20,960,587	\$861,871
FY 09-10	8,882	444	\$47,174	\$2,912	\$25,861,275	\$27,076,686	\$1,215,411
FY 10-11	10,071	504	\$48,353	\$2,987	\$30,084,091	\$31,622,381	\$1,538,290

Fiscal Impact Summary Across State and Local Governments

A summary of the estimated revenue reductions from the tuition and scholarship tax credits and the estimated expenditure savings for all levels of government is provided in the table below. This summary totals the state General Fund revenue reduction from the tax credits, the net reduction from potential state appropriations reductions and local estimated expenditure reductions.

As seen in the table above, the cost of the state tax credits is not offset by the estimated potential expenditure savings at the state and local school district levels. Analysis of state and local school district expenditure savings is based on average teacher salaries and per pupil expenditures. Given the relatively small number of students and teachers impacted, if state funding were reduced, the school districts would tend to reduce part time instructors, or newer teachers, which due to lack of seniority earn well below the average salary used in this estimate. Using more of a marginal analysis, expenditure savings from a reduction in lower cost teachers would tend to be less than the expenditure savings estimates in this analysis. While our estimates presented above may be overstated relative to a true marginal analysis, average expenditures on teachers and other per pupil expenditures were used to reflect results that might be achieved with reorganization and other cost savings actions.

Fiscal Year	Tuition and Scholarship Tax Credits - Reduction to State General Fund	Estimated Potential State Appropriation Reduction	Estimated Potential Local Expenditure Reductions / (Increases) Net of State	Net Revenue Loss Combined Across All Levels of Government
FY 2006-07	\$ (29,036,032)	10,573,342	(\$354,407)	\$ (18,817,097)
FY 2007-08	\$ (62,123,068)	15,605,946	(\$631,864)	\$ (47,148,986)
FY 2008-09	\$ (106,798,849)	20,960,587	(\$861,871)	\$ (86,700,133)
FY 2009-10	\$ (171,523,089)	27,076,686	(\$1,215,411)	\$ (145,661,814)
FY 2010-11	\$ (231,590,070)	31,622,381	(\$1,538,290)	\$ (201,505,979)

Impact on Expenditures Per Pupil for Public School Students

Based on the preceding analysis, we can estimate the increased amount of per pupil expenditures necessary to fund the public schools and the tax credits in the proposed legislation. In FY 2006-07, we expect the number of public school children to total 670,000. Total expenditures for these students from all funds are estimated at \$10,121 per year for total expenditures of \$6.78 billion. See lines 1 through 3 in the table below. Once the estimated 3,790 students move to independent schools, 666,210 remain in the public schools. We estimate total school expenditures of \$6.77 billion for these remaining students, once the total of \$10.6 million in appropriation reductions at the state and local levels are subtracted. This results in total expenditures per pupil of \$10,162 for the remaining students, a \$40 per pupil increase from the original \$10,021 prior to the enactment of the proposed legislation. See lines 9 and 10 in the table below.

However, once the cost of the tax credits is included, the per pupil cost of public education rises to \$10,222 per student. This is \$101 per pupil higher than the estimated \$10,121 per pupil expenditures prior to the enactment of this proposed legislation. By FY 2010-11 when the legislation would be fully implemented, total expenditures per student for public education and the tax credits would be \$11,912, or \$521 per pupil higher than estimated per pupil expenditures without implementation of this proposed legislation.

		FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
1	Number of Public School Students	670,000	669,560	671,286	673,018	674,619
2	Estimated Per Pupil Expenditures	10,121	10,242	10,737	11,059	11,391
3	Estimated Total Public School Expenditures	6,780,922,600	6,857,633,520	7,207,597,782	7,442,906,062	7,684,585,029
4	Estimated Number of Students Moving to Independent Schools	3,790	5,431	7,082	8,882	10,071
5	Expected State Appropriation Reduction Per Pupil Moving to Independent Schools	2,790	2,873	2,960	3,048	3,140
6	Expected Local Expenditure Reduction Per Pupil Moving to Independent Schools	2,696	2,757	2,838	2,912	2,987
7	Net Local Expenditure Reduction / (Increase) Per Pupil Moving to Independent Schools	(94)	(116)	(122)	(137)	(153)
8	Remaining Public School Students	666,210	664,129	664,204	664,136	664,548
9	Estimated Total School Expenditures for Remaining Students	6,770,349,258	6,842,027,574	7,186,637,195	7,415,829,376	7,652,962,648
10	Estimated Per Pupil School Expenditures for Remaining Students	10,162	10,302	10,820	11,166	11,516
11	Estimated Total School and Tax Credit Expenditures	6,809,958,632	6,919,756,588	7,314,396,631	7,614,429,151	7,916,175,099
12	Estimated Per Pupil School and Tax Credits Expenditures	10,222	10,419	11,012	11,465	11,912
13	Total State Appropriation Reduction (58% of Average State Expenditures)	10,573,342	15,605,946	20,960,587	27,076,686	31,622,381
14	Expected Local Expenditure Reduction	10,218,935	14,974,082	20,098,716	25,861,275	30,084,091
15	Expected Local Expenditure Cost Net of State	(354,407)	(631,864)	(861,871)	(1,215,411)	(1,538,290)
16	Tuition and Scholarship Tax Credits state General Fund Reduction	(29,036,032)	(62,123,068)	(106,798,849)	(171,523,089)	(231,590,070)

Hypothetical Higher Risk Assessment

Although we do not expect more than 5% to 10% of the public school students in the applicable taxable income ranges to transfer to independent schools, we did estimate the exposure to the state if 50% of students in the higher income brackets did transfer. We repeated our analysis to include a higher expectation in the number of public school children and their parents claiming the proposed tax credits. Rather than the anticipated 5% of the families with taxable income between \$35,000 and \$50,000 and 10% of the families with taxable income between \$50,000 and \$75,000 claiming the tuition tax credit, we repeated the analysis with 50% of all students in families with taxable incomes between \$35,000 and \$75,000 claiming the proposed tuition credit.

Estimated State Revenue Impact Under the Hypothetical 50% Risk Assessment

Under this hypothetical analysis, we estimate that just over 10% of total public school students could move to independent schools by FY 2010-11 when the proposed legislation is fully implemented. These 63,326 students, as shown in the table below, would more than double the 53,000 students in independent schools at the beginning of the FY 2006-07 school year. Tuition tax credits would total \$384.7 million when fully implemented. The estimated donations and corresponding scholarship tax credit estimates are not expected to increase because of limited financial capacity of the donors to utilize more tax credits. Total tuition and scholarship tax credits claimed would reduce state General Fund revenue by \$470.9 million in FY 2010-11.

Hypothetical 50% Risk Assessment					
	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Public School Students Claiming Tuition Tax Credit	25,647	35,549	45,776	56,650	63,326
Total Students Taking Credit	34,518	53,756	84,982	129,733	169,074
Tuition Tax Credit Total	41,156,460	127,260,423	197,130,455	293,499,831	384,685,229
Scholarship Tax Credit Total	23,571,827	32,998,879	46,303,308	65,933,903	86,197,105
Total Tax Credits	64,728,287	160,259,302	243,433,763	359,433,734	470,882,334

We believe, however, that it is very unlikely that 50% of the higher income taxpayers would claim the tuition tax credit. First, independent schools, without the debt funding capabilities of public schools, will find it difficult to construct the new classrooms and schools necessary to house the additional students. Secondly, the cost savings afforded by the tuition tax credit reduces the cost of independent school tuition by only an estimated 24% to 34%, even if the parent has the tax liability to offset the proposed credits. We do not expect that this low level of cost savings would result in more than a 100% increase in the number of independent school students. As for any additional scholarships from a scholarship granting organization, they cannot be guaranteed. Most parents, especially during the phase-in period of the proposed legislation, will be doubtful of the availability of these scholarships.

Estimated State Appropriation Reduction Under the Hypothetical 50% Risk Assessment

As stated earlier, based on data from the state Appropriation Act and the Local Government Finance Report, we estimate that expenditures directly related to the number of students, such as EFA funding and school district employer contributions account for 58% of all state expenditures for K-12 school operating expenditures. While this higher risk assessment estimates a larger number of public school students moving to independent schools, the 63,326 estimate accounts for less than 10% of all current public school students. We therefore expect that state appropriation reduction estimates based on 58% of all state expenditures per pupil is realistic. Multiplying 58% of average per pupil state expenditures times the higher number of students moving to independent schools provides the potential appropriation reductions presented in the table below.

Hypothetical 50% Risk Assessment			
Fiscal Year	Students Moving to Independent Schools from Public Schools	58% of Avg. State Expenditures for K-12 Operations	Potential State Appropriation Reductions
FY 2006-07	25,647	2,790	\$71,549,247
FY 2007-08	35,549	2,873	\$102,148,838
FY 2008-09	45,776	2,960	\$135,483,598
FY 2009-10	56,650	3,048	\$172,697,548
FY 2010-11	63,326	3,140	\$198,839,042

Estimated Local School District Expenditure Reductions Under the 50% Risk Assessment

With less than a 10% reduction in the number of students, we estimate that local school districts' savings will continue to be based on the anticipated reduction in the number of teachers and a small amount of the remaining fixed costs. At this marginal reduction in the number of students, we estimated reductions in local school districts expenditures if they maintained the same number students per teacher. Given these actions, local school districts would have revenue increases net of the state savings of \$9.7 million once the legislation was fully implemented.

Hypothetical 50% Risk Assessment							
Fiscal Year	Students Moving to Independent Schools from Public Schools	Estimated Reduction in the Number of Teachers - 20 to 1 Student to Teacher Ratio	Estimated SC Average Teacher Salary	Estimated Per Pupil Local Expenditure Reduction (Teacher Salaries plus 5% of total local expenditures)	Estimated Total Local Expenditure Reduction (Teacher Salaries plus 5% of total local expenditures)	Estimated Potential State Appropriation Reduction	Estimated Potential Local Revenue Increase Net of State
FY 06-07	25,647	1,282	\$43,805	\$2,696	\$69,151,277	\$71,549,247	\$2,397,969
FY 07-08	35,549	1,777	\$44,901	\$2,757	\$98,012,966	\$102,148,838	\$4,135,872
FY 08-09	45,776	2,289	\$46,023	\$2,838	\$129,912,696	\$135,483,598	\$5,570,903
FY 09-10	56,650	2,833	\$47,174	\$2,912	\$164,945,547	\$172,697,548	\$7,752,001
FY 10-11	63,326	3,166	\$48,353	\$2,987	\$189,166,398	\$198,839,042	\$9,672,644

Fiscal Impact Summary Across State and Local Governments Under the 50% Risk Assessment

By FY 2010-11, the hypothetical 50% risk assessment of higher tax credit utilization along with higher expected expenditure savings results in a net revenue loss of \$281.7 million to state and local school districts combined. A summary of the estimated revenue reductions from the tuition and scholarship tax credits and the estimated expenditure savings for all levels of government for the analysis with the higher number of public school students moving to independent schools is provided in the table below. This summary includes the revenue reduction from the tax credits to the state General Fund and the estimated potential state and local appropriation reductions.

50% Risk Assessment				
Fiscal Year	Tuition and Scholarship tax credits - Reduction to State General Fund	Estimated Potential State Appropriation Reduction	Estimated Potential Local Expenditure Reduction Net of State	Net Revenue Gain/(Loss) Combined Across All Levels of Government
FY 2006-07	(64,728,287)	71,549,247	(2,397,969)	4,422,991
FY 2007-08	(160,259,302)	102,148,838	(4,135,872)	(62,246,336)
FY 2008-09	(243,433,763)	135,483,598	(5,570,903)	(113,521,067)
FY 2009-10	(359,433,734)	172,697,548	(7,752,001)	(194,488,187)
FY 2010-11	(470,882,334)	198,839,042	(9,672,644)	(281,715,936)